Supreme Court, U.S.
FILED
OCT 31 1991
OFFICE OF THE CLERK

(5)

No. 91-381

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

THE PEOPLE OF THE STATE OF ILLINOIS
ex rel.* THE OFFICE OF PUBLIC COUNSEL *et al.
Petitioners,

v.

THE ILLINOIS COMMERCE COMMISSION *et al.*
Respondents.

Petition For Writ Of Certiorari
To The Illinois Supreme Court

REPLY TO BRIEFS IN OPPOSITION TO THE OFFICE OF PUBLIC COUNSEL'S PETITION FOR WRIT OF CERTIORARI

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Printed by Authority of the State of Illinois (P.O. 35258—80—10-31-91)

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QUESTION PRESENTED

Whether the Illinois Supreme Court correctly held that the Illinois Commerce Commission is preempted by the Sixth Amendment's Supremacy Clause and the Natural Gas Act's filed rate doctrine from allocating take-or-pay gas costs between local segments of the gas industry even after the Federal Energy Regulatory Commission determined that states were to implement its allocation policy pursuant to the Natural Gas Act. United States Constitution, U.S. Const., Art. VI, cl. 2 (Petit. at A136); Natural Gas Act, 15 U.S.C. Sect. 717 et seq. (1988) (Petit. at A136).

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REASONS FOR GRANTING THE WRIT

The Illinois Supreme Court improperly ruled that the Illinois Commerce Commission ("Commission" or "ICC") is preempted by the Supremacy Clause of the United States Constitution, U.S. Const., Art. VI, cl. 2, and the filed rate doctrine from allocating take-or-pay costs to all segments of the gas industry as intended by the Federal Energy Regulatory Commission ("FERC"). *General Motors Corp. v. Illinois Commerce Commission*, 143 Ill. 2d 407, 574 N.E. 2d 650 (1991). This is a case in which a petition for certiorari should be granted. FERC's Order 500 does not establish a FERC-mandated rate that can be described in any way as a filed rate. The take-or-pay charges at issue are not subject to the exclusive jurisdiction of Federal Energy Regulatory Commission. Moreover, FERC Order 500 does not preempt state regulatory agencies from altering or denying the pass-through of take-or-pay liabilities to LDCs. Finally, because Congress has not expressed an intent to occupy the entire field of natural gas regulation, FERC's intent regarding the preemptive effect of its actions is entitled to deference.

The question presented to this Honorable Court is whether the ICC is preempted by the Supremacy Clause and the filed rate doctrine from implementing the intent of FERC to allocate take-or-pay gas costs between local segments of the gas industry. This statement of the issue and the related discussions in the Petition for Certiorari do not "improperly expand the scope of review of the [ICC]'s decision" with regard to take-or-pay charges in Illinois. Brief of the ICC at 11. The question before this Court is not, as Respondents argue, limited to whether the ICC is foreclosed from reviewing the prudence of the LDC purchasing decisions with regard to direct-billed, FERC-allocated, take-or-pay costs. *Id.* Rather, the appropriate focus is on the preemption analysis and the stated intention of FERC not to preempt take-or-pay allocation at the state level.

Moreover, the filed rate doctrine as applied by this Court in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 106 S.Ct. 2349, 90 L.Ed. 2d 943 (1986) and *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 108 S.Ct. 2428, 101 L.Ed. 2d 322 (1988) does not preempt state commissions from allocating take-

or-pay liabilities pursuant to orders of FERC. Thus, the Illinois Supreme Court's reliance on those cases is misplaced.

I. United States Supreme Court Case Law

A. *Nantahala* and *Mississippi Power* Are Not Applicable

Respondents rely on *Nantahala* and *Mississippi Power* for the proposition that the ICC is precluded from allowing anything but full recovery by the LDCs of their take-or-pay liabilities to their interstate pipeline suppliers. Northern Illinois Gas et al. at 9; ICC at 12; Interstate Power et al. at 7. However, both cases are clearly distinguishable from the case at bar. The parties submit that the liabilities in question are rates to which the filed rate doctrine is applicable. However, even assuming the filed rate doctrine could apply, neither *Nantahala* nor *Mississippi Power* bring this situation within the ambit of the filed rate doctrine. In both cases, there was a readily apparent intention *on the part of FERC* to preempt state regulators from reallocating FERC-approved cost allocations. This Court merely gave effect to that intention. In the instant case, FERC orders established mechanisms for pass-through of pipeline take-or-pay buyout and buy down gas liabilities. There is no intention on the part of FERC to preempt state regulators from allocating charges.

Nantahala concerned an attempt by the North Carolina Utilities Commission to alter a FERC determined allocation of costs between two related utility companies. This Court held that the North Carolina Commission's action was preempted since it interfered with FERC's plenary authority over wholesale rates. The interference or conflict resulted from the North Carolina Commission's attempt to impute more low-cost electricity than was used by FERC to calculate its wholesale rate.

Mississippi Power involved the Mississippi Public Service Commission's determination as to whether it could review the prudence of management decisions to incur costs associated with the Grand Gulf nuclear power plant in light of a FERC opinion which allocated the capacity costs among the multi-state members of the nuclear power plant holding company, Middle South Utilities. This Court determined that the FERC proceedings preempted a prudence inquiry by the Mississippi Commission. Furthermore,

it was determined that the proposed prudence inquiry would conflict with the authority of the FERC since the federal agency could have addressed prudence if it had been raised.

Both cases involved FERC's establishment of rates that were based upon a determination of entitlements of power. The states had attempted to establish retail rates based upon different assumptions of power entitlement. Clearly, in these cases, the assumption of different entitlements would affect the determination of rates, since different fixed costs would be allocated. Thus, the Court found that the filed rate doctrine controlled since the states were interfering in FERC's clear statutory ability to establish wholesale rates based upon cost of service. The determination of entitlements and the allocation of capacity costs in the two cases were an integral part of that determination.

In the instant case, however, *FERC had no jurisdictional ability to order or establish the sharing of take-or-pay costs by local state distribution companies in its sharing proposal.* FERC expressly noted the fact that its sharing policy was intended to apply to LDCs, but that it did not have the jurisdiction to accomplish this cost allocation. FERC Order No. 500, 89 PUR 4th at 331. Thus, the filed rate doctrine cannot apply since the predicate for its application, i.e. FERC jurisdiction, does not exist.

B. Federal Legislation Does Not Completely Occupy The Field of Natural Gas Regulation

More generally, the Office of Public Counsel ("OPC") is not arguing that the FERC's and the states' rights are concurrent as proposed by the Interstate Power et al. in its Brief at 5-6, ICC Brief at 18. Rather, the OPC is arguing that in enacting the Natural Gas Act ("NGA"), 15 U.S.C. Section 171 et seq. (Petit. at A136), Congress did not intend to preempt states in cases such as the one before this Court. It has been well settled that any subject area not reserved to the Federal government's jurisdiction allows preexisting state power to be undisturbed. *FPC v. Southern California Edison Co.*, 376 U.S. 205, 213, 215, 84 S.Ct. 644, 650-51, 11 L.Ed. 2d 638 (1964). Indeed, relatively few areas have been found to be fully occupied by Federal government regulation, to the exclusion of state regulation. *Zschernig v. Miller*, 389 U.S. 429 (1968), *reh'g den.*, 390 U.S. 974 (1968).

This Court has spoken on the issue of Federal versus state jurisdiction of natural gas and found that Federal regulatory authority is not exclusive. In *Panhandle Eastern Pipe Line Co. v. Public Service Comm'n of Indiana*, it was held that "in no manner" was the Natural Gas Act to "usurp" state authority. 332 U.S. 507, 520, 68 S.Ct. 190, 197, 92 L.Ed. 128 (1947).[1] "The Natural Gas Act created an articulate legislative program based on a clear recognition of the respective responsibilities of the federal and state regulatory agencies." *Id.* Additionally, in *FPC v. Panhandle Eastern Pipe Line* this Court stated, "[n]either state nor federal regulatory body was to encroach upon jurisdiction of the other." 337 U.S. 498, 513, 69 S.Ct. 1251, 1260, 93 L.Ed. 1499 (1949). The clear intent of Congress in enacting the Natural Gas Act was to "supplement" state regulatory power so to promote "harmonious and comprehensive regulation of the industry." *Id.*

II. Federal Agencies Are Empowered To Determine The Effect Of An Enabling Statute

A. A Federal Agency's Interpretation Of Its Enabling Statute Is Central To A Preemption Analysis

A federal agency's intent with respect to the preemptive effect of its actions is relevant in cases where (i) there is no congressional intent to preempt state action in a particular area, and (ii) the proposed state regulation does not in fact conflict with federal regulation. *Arkansas Electric Cooperative v. Arkansas Public Service Comm'n*, 461 U.S. 375, 384, 103 S.Ct. 1905, 1912, 76 L.Ed. 2d 1 (1983). *See* Petition at 19; Northern Illinois Gas Co. et al. Brief at 15; ICC Brief at 4. Where Congress does not act to make federal jurisdiction over a particular subject matter exclusive, such as in the area of natural gas regulation, the intent of the agency exercising that jurisdiction becomes the focus of the federal preemption discussion. *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837, 842-43, 104 S.Ct. 2778,

[1] "The jurisdiction granted to the Federal Power Commission by the Natural Gas Act necessitates close correlation with state regulatory bodies." *Panhandle Eastern*, 332 U.S. at 520, 68 S.Ct. at 190. (Footnote N. 18)

2782 (1984). Respondents argue that Congress has fully occupied the field of natural gas regulation to the exclusion of the states such that state commissions are preempted from acting. However, many sales of gas have numerous components which allow federal and state jurisdiction to be interlocking. *Public Utilities Comm'n of State of Cal. v. FERC*, 900 F.2d 269, 274 (D.C. Cir. 1990). Thus, it is important for the Federal authority to clarify its role in particular areas not specifically addressed by Congress.

Where an order of a Federal agency is needed to implement its authority, a Federal agency can interpret its own enabling statute to set-out the parameters of its jurisdiction. (i.e. allow an equitable sharing). It has long been held by this Court that if Congress has explicitly left a gap for the Federal agency to fill, there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation. "The power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." *Morton v. Ruiz*, 415 U.S. 199, 231, 94 S.Ct. 1055, 1072, 39 L.Ed. 2d 270 (1974). Such legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute. *See U.S. v. Morton*, 467 U.S. 822, 834, 104 S.Ct. 2769, 2776, 81 L.Ed. 2d 680 (1984). In certain circumstances the delegation by the legislature is implicit, rather than explicit. In this circumstance, the court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the agency. *INS v. Jong Ha Wang*, 450 U.S. 139, 144, 101 S.Ct. 1027, 1031, 67 L.Ed. 2d 123 (1981).

When reviewing a Federal agency's interpretation of its enabling statute, the reviewing court should give an administrative agency considerable deference, even though the case might be characterized as involving a limit on the agency's jurisdiction. *The Business Roundtable v. SEC*, 905 F.2d 406, 408 (1990), *citing*, *Chevron USA*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed. 2d 694 (1984). As this Court stated in *Mississippi Power*: "it is plain that giving deference to an administrative interpretation of its statutory jurisdiction or authority is both necessary and appropriate." 487 U.S. 354, 108 S.Ct. at 2444, 101 L.Ed. 2d 322 (1988). Therefore, Federal agencies clearly have the power to set policy

concerning the effect of their interpretation of its own enabling statute.

B. FERC's Policy Regarding Take-Or-Pay Liabilities Are Not Orders Mandating FERC Filed Rates

Take-or-pay liabilities are not FERC-mandated, nor FERC-approved costs which are subject to the preemptive effect of the filed rate doctrine. The filed rate doctrine, contrary to the assertions of Respondents, has no effect on take-or-pay liabilities. Brief of Interstate Power et al. at 7; Brief of ICC at 15-16; Northern Illinois Gas et al. at 14. As a general rule, FERC wholesale rates are costs that must be recovered pursuant to the filed rate doctrine. However, the filed rate doctrine is not controlling in this case because FERC's policy orders regarding take-or-pay charges were policy orders directing local, state commissions to allocate liabilities at the state level.[2] Contrary to Respondents' arguments, take-or-pay costs are not traditional wholesale purchased gas costs. FERC designated take-or-pay costs as gas charges, not payments for gas, so that state commissions could allocate the liability to all segments of the industry. Significantly, take-or-pay costs are not payments for the purchase of gas, but, rather, payments for the failure to purchase gas. *Diamond Shamrock Exploration Co. v. Hodel*, 853 F.2d 1159 (5th Cir. 1988).

The costs in question are clearly not purchased gas costs which would be subject to the filed rate doctrine. Respondents have cited nothing to bolster their argument that FERC's policy state-

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[2] FERC fully expected state commissions to have authority to consider take-or-pay cost allocation questions at the state level. FERC explained that state commissions would not be hindered by the filed rate doctrine in their efforts to allocate take-or-pay liabilities at the state level:

> Several state commissions also express concern over the Commission's reference to *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 90 L. Ed. 2d 943, 106 S.Ct. 2349 (1986).
>
> . . .
>
> The Commission does not believe that *Nantahala* precludes state regulators from designing LDC rates, or, in appropriate circumstances from reviewing the prudence of LDCs' purchasing decisions insofar as they effect take-or-pay costs. Order No. 500 at 331.

ments pertaining to take-or-pay costs were regarded by FERC to be statements concerning traditional wholesale purchased gas costs. In fact, FERC made it abundantly clear that its Order No. 500 take-or-pay liability mechanism was to be characterized as costs which were not subject to the filed rate doctrine. FERC Order No. 500, 89 PUR 4th 313, 326 (1987). Indeed, take-or-pay charges have not been treated or considered part of purchased gas cost proceedings. They have been treated as a separate item apart from purchase gas cost cases. 18 C.F.R. Section 2.76(b) (1988). Thus, the Federal agency charged with the responsibility for the regulation of gas level, expressly noted that these costs are not purchased gas costs subject to Federal preemption.

Moreover, the Fifth Circuit Court of Appeals has determined that take-or-pay costs are not payments for the sale of gas. *Diamond Shamrock*, 853 F.2d 1159, 1167 (5th Cir. 1988). Specifically, the court rejected the attempt of the federal government to recover royalty payments on take-or-pay settlements finding that such settlements did not represent payments for the gas. As the court stated:

> Take-or-pay payments are not . . . payments for the sale of gas. Far from being payments for the purchase of gas, take-or-pay payments are payment for the pipeline-purchaser's *failure* to purchase (take) gas.

Id. at 1167. Payments for the sale of gas are normally rates which are on file with FERC. It is clear, however, that these costs are not current costs of purchasing gas for the pipelines. Thus, since these charges are not payments for the sale of gas, it is correct to conclude that take-or-pay charges are not preempted because these charges are not filed rates with FERC. Therefore, the filed rate doctrine has no effect. These liabilities can be allocated at the state level because FERC classified these charges as non-current costs.

III. There Is An Independent State Law Basis To Conduct A Meaningful Prudence Review

Respondents claim the Illinois Supreme Court suggested that "there would be serious state law issues that would have to be

resolved before OPC would be entitled to the relief requested." *Id.* at 21. This is not the case at all. The Illinois Supreme Court did not rule on this issue whatsoever. Moreover, Respondents neglect to refer to the Illinois Appellate Court's ruling which ordered a remand of the proceeding to the ICC. The court stated, "[a]t the proceedings following remandment of this cause, the ICC is to admit evidence pertaining to (a) the sharing of the take-or-pay costs of LDC's between the LDC's and ratepayers and (b) the factors relevant to the prudence of the past purchasing practices of the LDC's as they relate to take-or-pay costs." (Petition at A64).[3] Indeed, if the Illinois Supreme Court truly believed it could not decide the issue because there was no state law basis to conduct a prudence review, as was argued by the Respondents, the court would not have addressed the preemption issue at all.

The Commission could make an allocation based upon general risk sharing. This Court approved risk sharing practices by state commissions in *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 312, 102 L.Ed. 2d 646, 660, 109 S.Ct. 609 (1989). Moreover, the ICC approved a risk sharing methodology in Central Illinois Light Company, ICC Docket 83-0177, at 11-13 & 15, Cancellation of Duck Creek II. Risk sharing could be made regardless of the prudence practices of an LDC because all segments of the gas industry were intended by FERC to share the cost of take-or-pay liability. As discussed in the OPC's Petition for Certiorari, FERC noted numerous reasons for the development of the take-or-pay liability, and few if any of those reasons were the fault of any single party in the gas industry. Thus, FERC concluded, there should be an equitable sharing between producers, pipelines, LDCs and consumers.

The Commission can also make an allocation of these take-or-pay costs following a prudence review of LDC purchasing decisions. The Respondents' argument that a state commission prudence

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[3] Due to the ICC's decision pertaining to the applicability of the preemption and filed rate doctrines, the ICC struck testimony of Witness Mr. Rosenberg regarding the sharing of take-or-pay costs between LDCs and ratepayers. Additionally, factors pertaining to a prudence review of past purchasing practices of LDCs were also struck. (Petitioner A43).

review would be meaningless is merely a final effort by them to divert this Court's attention from the central issue. The fact that the LDCs could not predict FERC would issue policy orders regarding take-or-pay liabilities is of little consequence. Brief of Northern Illinois Gas et al. at 20. The LDCs were making purchasing decisions pertaining to take-or-pay contracts long before the issuance of the FERC orders. FERC's orders were a response to, not a precursor of, take-or-pay liabilities. A prudence review by a state commission would focus on the LDC decision to purchase gas on the spot market and not from the pipelines, thereby exposing the LDC to take-or-pay liability. Thus, the prudence review would be meaningful.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari of the Illinois Office of Public Counsel should be granted.

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